The Golden State's Not-So-Golden Goose

California set up a plan to invest state pension funds in socially responsible businesses. The results have been disastrous

by Christopher Palmeri

In March 2000, California State Treasurer Philip Angelides announced a bold new initiative. Angelides felt the Golden State could do good for both the citizens of the world and its retirees by taking state pension fund money out of two asset classes that were performing horribly at the time, tobacco stocks and emerging markets, and reinvesting in something with a social benefit—businesses and real estate in low-income neighborhoods in his home state. Angelides called the initiative the "Double Bottom Line," because it would produce both a social return and strong investment results.

Eight years later, Angelides is gone, but the state's two big pension funds are still wrestling with the fallout of the initiative. A recent report from the California State Teachers' Retirement System (CalSTRS), revealed that the $170 billion fund, the nation's third-largest, would have been $1 billion richer if it had stayed in tobacco stocks. Meanwhile, investments in California real estate are proving particularly painful for the nation's largest fund, the $230 billion California Public Employees' Retirement System (CalPERS). Among other bad deals, it faces a loss of nearly $1 billion on one land investment alone.

The performance of the Double Bottom Line plan illustrates the potential drawbacks of socially responsible investing. While it's fine for individual investors to vote their conscience by putting money into the growing number of socially responsible mutual funds (BusinessWeek.com, 7/8/08), they should know that it could lead to weaker investment performance. Although the most closely watched index of socially responsible companies, the Domini 400, has slightly outperformed the S&P 500 since its inception in 1990, it has underperformed in the past 10-, 5-, and 1-year time periods. Like it or not, people do gamble, smoke, and buy expensive nuclear-powered war machines.

CONSEQUENCES TAKE YEARS TO SHOW UP

The Double Bottom Line saga also provides a cautionary tale for all public funds that let investment decisions be made by politicians, rather than by the investment professionals hired to do so in the first place. Politicians on the campaign trail can generate fast headlines by announcing bold investment initiatives, but the bottom-line consequences of such actions take years to show up. Angelides has since left public office, having lost his bid to replace Arnold Schwarzenegger as California's governor in 2006.

A spokesman for the former treasurer notes that many CalPERS investments in California real estate "either predated his involvement, occurred after he left, were decided upon by staff, or were unrelated to Phil's policy initiatives." In an e-mail response to BusinessWeek.com, Angelides said: "I am extraordinarily proud that during my tenure as State Treasurer, California's pension funds set new standards for responsible investing, posted record returns, and boosted pension fund assets from $244 billion to $386 billion. I am particularly proud of our successful efforts to invest in urban, inner-city neighborhoods, where CalPERS has earned annual returns of
more than 20% while creating jobs and hope in communities too often left behind."

The first part of the Double Bottom Line to unravel was the push to reduce investments in emerging markets. Angelides proposed, and CalPERS approved, a method for screening foreign countries based on such criteria as whether they had a free press and laws in place to protect workers. The program was a diplomatic disaster for CalPERS after countries such as Indonesia, Malaysia, the Philippines, and Thailand got dropped from the list of approved investments.